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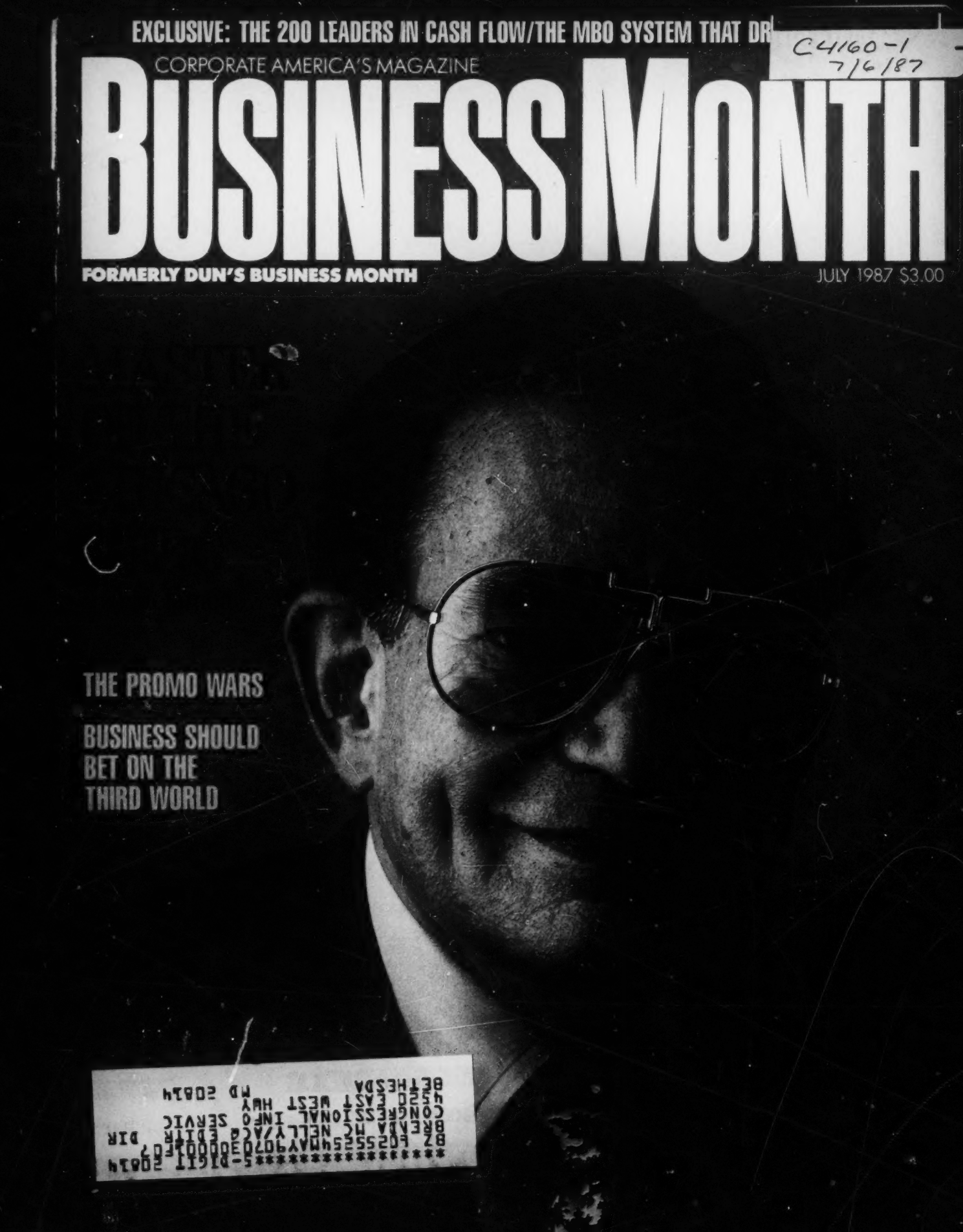

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Business Should Bet On The Third World

That's the view of world-renowned expert Albert O. Hirschman, who maintains that debt write-offs will ignite a new round of economic growth.

by Marc Levinson

For half a decade, dictators, debts and declining economies have caused American business to shun the once promising Third World. But the tide may be turning. Albert O. Hirschman, one of the nation's top experts on Third World economies, contends that the recent write-offs of bank debts could ignite sustained expansion in the developing world and create new markets for American exports and a slew of investment opportunities. "If we get the debt behind us, we could look forward to another period of fairly good growth," Hirschman says. "It's already picking up."

A world-renowned authority on Latin America, few economists are more qualified than Hirschman, 72, to assess the outlook for the Third World. A former professor at Yale, Columbia and Harvard and a longtime consultant to the Colombian government, he gained prominence in the 1960s by insisting that each Third World nation has unique problems that cannot be solved by rigid plans imposed by the World Bank or the International Monetary Fund. Now at the famed Institute for Advanced Study in Princeton, where scholars receive stipends just to think and write, Hirschman is optimistic about the outlook for the developing countries. "The prospect of economic growth under democratic governments should make multinational corporations sit up and take notice," he says.

Most U.S. corporations, particularly manufacturers, haven't ventured into developing countries since the international debt crisis erupted in 1982. U.S. manufacturing investment in Latin America, for example, was smaller at the end of 1985, the most recent year for which figures are available, than it was at the end of 1981. Direct U.S. investment in sub-Saharan Africa fell 25% over the same period. Even on the fast-growing Pacific rim, the multinationals' interest in such erstwhile hot economies as Malaysia and the Philippines has been simmering down.

But now, Hirschman asserts, fundamental economic changes have set the stage for a significant turnaround. These countries are now more highly developed economically. Typically, they have only one-third of their labor force in agriculture, compared with two-thirds twenty years ago. The massive move to the cities has produced a more sophisticated, healthier and more literate labor force.

Ironically, Hirschman says, the big reason for optimism is the likelihood that the Third World will default on its debt to the banks. Either write-offs or defaults will give the developing world the foreign exchange to buy imports, which in turn will stimulate their

economies. Even Citicorp Chairman John Reed suggests that both banks and debtor nations would be better off if the banks could swap debt for equity in local companies. This would give them a stake in a growing economy instead of a claim on a stagnant one.

At the same time, virulent nationalism has abated. As a result, investment proposals are likely to get a much warmer reception than was the norm a decade ago. "The developing countries are less ideological than they used to be," maintains Hirschman. "Things are likely to be looked at pragmatically in most countries."

The Third World has also achieved greater political stability, says Hirschman. The extreme authoritarian regimes of the recent past have made many people value basic liberties and democratic government. "People who have gone through these [dictatorial] regimes are convinced that democracy is worthwhile in itself," he says.

But, he cautions, companies must approach foreign investment differently than in the past. Most of these nations now have strong unions and are increasingly concerned about pollution, monopolistic behavior and consumer protection. Thus, the Third World can no longer be viewed as a place to avoid high labor costs or regulation. "The reasons for locating abroad should be that the economy is vigorous or that it's a good place from which to export, rather than the lack of antitrust or labor laws," Hirschman says.

Hirschman: Argentina, Colombia and India are attractive right now

In choosing a country to invest in, he says, do not follow the crowd. "One of the problems of businessmen is that they all go into one country, because that country looks 'good' at a particular point. But the climate tends to change if everybody comes in. You get a lot of antiforeign feeling."

It might be far better to invest in a country whose reputation is "bad," since reputations tend to persist long after conditions have changed, Hirschman maintains. This is certainly the case right now with long unpopular countries like Argentina, India and Colombia. Argentina's new democratic government has built an increasingly efficient agricultural sector; India has created a vibrant consumer economy; while Colombia has experienced several years of steady economic growth.

Sitting in his enormous book-lined office, overlooking a pond and the famous Institute Woods in which Albert Einstein once strolled, the German-born scholar suggests that one attitude hasn't changed: concern about foreign domination. Here, too, companies must adopt new strategies. He advises multinationals as they move into new product lines to systematically spin off older businesses to locally owned firms. If a company transfers technical skills to local entrepreneurs, it will be seen as a positive factor in the country's development. "Otherwise, a foreign company exposes itself to hostility from occupying a key position in the economy," Hirschman warns. "A company should be a moving target, not a sitting one."

American companies will do best in developing countries where there is a strong domestically owned private sector, Hirschman asserts. Then local business leaders, instead of foreigners, can raise their voices against government mismanagement and corruption. Brazilian business, for example, was a major influence in bringing back civilian government after years of economic mismanagement by a military junta. If there are to be indigenous business voices to speak out against government incompetence, "foreign companies shouldn't dominate too much of a nation's economy," argues Hirschman.

If he is right, business would miss a major opportunity if it is too scarred by past experience to take another gamble on the Third World. ■

TEN COUNTRIES THAT HAVE TURNED AROUND

Five years ago, business stopped investing in the debt-ridden Third World countries as their economies collapsed in the wake of the world-wide recession. Now, the developing nations are taking off again.

COUNTRY	1982 GROWTH RATE	1987 GROWTH RATE (PROJ.)
Argentina	-4.6%	4%
Brazil	-.9%	3%
Colombia	.9%	4%
Ivory Coast	-3%	4.5%
Kenya	1.8%	4%
Mexico	-.6%	3%
Peru	-.9%	5%
South Korea	5.5%	8%
Taiwan	3.8%	7.5%
Venezuela	-.7%	2%

Source: International Monetary Fund, The Conference Board

CASH FLOW THE TOP 200

Cash flow of the 200 big nonfinancial companies in BUSINESS MONTH's annual survey grew 3% in 1986, down sharply from the ebullient 5% rate of the year before. Still, it exceeded the economy's 2.5% growth.

Tax reform and the loss of the investment tax credit was one reason for the slowing of cash-flow growth. Another was that corporate restructuring, which helped produce big increases for some companies in 1985, had less impact last year.

But the restructurings and improved business conditions also helped more and more companies get healthy. Last year only 67 of the 200 had negative discretionary cash flow, compared with 98 the year before and 82 in 1984. Discretionary cash flow is the amount remaining after dividend payouts, capital spending and debt due in one year.

International Business Machines, with $11.8 billion in cash flow, took over the top spot in the rankings from Exxon, which fell to third. With $4.1 billion in discretionary cash flow, IBM also led in this important category. Compare the leaders' numbers year to year, and it's easy to see why. IBM's 1986 gross cash flow was up by more than $2 billion, while Exxon's fell $40 million.

In 1985 General Motors was second in the overall rankings and its rival Ford Motor Co., sixth; this year, Ford ranks second and GM fifth. American Telephone & Telegraph climbed one notch into fourth place.

Not only Exxon but other oil companies lost ground. Chevron went from fourth to sixth. Amoco, displaced from seventh by BellSouth, fell to nineteenth; and Atlantic Richfield plummeted from ninth to fortieth. Texaco remained in eighth place and Mobil in tenth—just behind GTE, which, like BellSouth, made the top ten for the first time.

The 1986 list includes some of the year's most popular stocks in cash-loaded industries such as food, consumer products, drugs and publishing. The raiders went after several cash-rich companies, including Lucky Stores, Burlington, Goodyear and Allegis. Others companies, such as FMC Corp., used their cash flow for debt-laden recapitalizations to defend themselves against potential raids.

BUSINESS MONTH ranks the companies according to the dollar value of gross cash flow generated from operations in 1986. The tables also show the per cent change from the year before, net income, discretionary cash flow compared to the previous year's, return on equity, the debt-equity ratio, total revenues and cash flow as a percentage of revenues. Because cash-flow analysis is an increasingly popular tool on Wall Street *(page 50)*, a new key yardstick has been added: the ratio of market value to cash flow.

—L.N.

COMPANY	CASH FLOW		NET INCOME		DISCRETIONARY CASH FLOW		RETURN ON EQUITY	DEBT TO EQUITY	REVENUES	CASH FLOW TO REVENUES	MARKET VALUE/ CASH FLOW RATIO
	($Millions '86	% Change vs. '85	($Millions '86	% Change vs. '85	($Millions '86	($Millions '85	%		$Millions	%	
1. International Business Machines	11,830	22.3	4,789	–26.9	4122	71	13.9	.16	51,250	23.1	6.2
2. Ford Motor	7,624	41.9	3,285	30.6	3363	540	22.1	.23	62,716	12.2	1.9
3. Exxon	7,061	–40.1	5,360	10.1	–1,302	–54	16.7	.25	69,888	10.1	7.1
4. American Telephone & Telegraph †	6,785	18.9	314	–79.8	490	–522	1.7	.56	53,680	12.6	4.0
5. General Motors	5,842	–47.1	2,945	–26.4	–7,979	–494	9.6	.40	102,813	5.7	3.6
6. Chevron	4,489	–25.2	715	–53.8	880	1,130	4.6	.54	24,351	18.4	3.5
7. BellSouth	4,200	14.6	1,589	12.1	–179	122	14.1	.60	11,444	36.7	4.4
8. Texaco	4,121	–10.7	725	–41.2	1,138	1,470	5.3	.66	31,613	13.0	2.1
9. GTE	3,962	7.0	1,184	NM	–334	–822	15.0	1.20	15,112	26.2	3.2
10. Mobil	3,873	–4.9	1,407	35.3	–69	128	9.2	.61	44,866	8.6	4.2
11. Du Pont (E.I.)	3,857	–5.6	1,538	37.6	292	198	11.6	.37	27,148	14.2	5.2
12. Bell Atlantic	3,310	16.5	1,167	6.8	312	26	14.0	.73	9,921	33.4	4.1
13. Pacific Telesis	3,268	30.5	1,079	16.2	332	–428	13.9	.74	8,977	36.4	3.5
14. American Information Tech.	3,227	8.3	1,138	5.6	276	268	15.0	.62	9,362	34.5	3.9
15. NYNEX	3,123	12.9	1,215	11.0	16	31	14.0	.62	11,342	27.5	4.2
16. General Electric	3,011	16.2	2,492	6.7	–164	–566	16.5	.41	35,211	8.6	13.0
17. RJR Nabisco †	3,079	101.6	1,080	7.9	1,380	–342	18.4	1.03	15,978	19.3	4.0
18. Chrysler	2,836	7.0	1,404	–14.2	497	957	26.3	.47	22,586	12.6	1.9
19. Amoco	2,794	–41.9	747	–61.8	–608	–181	6.6	.33	18,281	15.3	6.0
20. Southwestern Bell	2,693	5.4	1,023	2.7	102	–164	13.1	.77	7,902	34.1	4.2
21. US West	2671	12.5	924	–0.1	188	–193	12.7	.71	8,308	32.1	3.8
22. Philip Morris	2,336	122.9	1,478	17.8	477	–136	26.1	1.22	20,681	11.3	7.3
23. ITT	1,980	44.1	528	84.3	1,273	404	7.7	.41	7,596	26.1	3.8
24. Boeing	1,905	–26.5	665	17.5	906	1,870	13.8	.06	16,341	11.7	4.2
25. Standard Oil	1,872	–32.7	–311	NM	–731	–143	–4.4	.53	9,219	20.3	6.2
26. USX	1,843	5.4	–1,593	NM	248	1	–35.6	1.81	14,000	13.2	3.0
27. PepsiCo	1,795	190.2	458	9.0	571	–447	22.3	1.39	9,291	19.3	3.8
28. Xerox	1,678	3.4	488	28.3	236	262	9.4	.40	9,355	17.9	3.5
29. Union Pacific	1,654	22.3	–414	NM	CF	–14.2	–13.1	.81	6,574	25.2	4.0
30. Unocal	1,598	–0.8	176	–45.9	511	–291	10.5	3.17	7,482	21.4	1.9
31. Dow Chemical	1,564	119.1	741	NM	136	–667	14.3	.71	11,113	14.1	7.2
32. Minnesota Mining & Mfg.	1,515	24.5	779	17.3	387	–114	17.5	.19	8,602	17.6	8.8
33. American Home Products	1,456	77.2	779	8.6	786	201	32.7	.02	4,927	29.6	7.8
34. Union Carbide	1,451	59.3	130	NM	–490	CF	12.9	3.50	6,343	22.9	2.0
35. Digital Equipment[4]	1,347	109.0	617	38.2	781	71	11.0	.06	7,590	17.7	10.0
36. Eastman Kodak	1,328	27.7	374	–12.7	CF	CF	5.9	.32	11,550	11.5	11.7
37. Rockwell International[7]	1,322	45.0	611	2.7	518	125	19.3	.23	12,296	10.8	4.9
38. Burlington Northern	1,308	–13.4	–529	NM	318	65	–15.8	1.04	6,941	18.9	3.0
39. Johnson & Johnson	1,304	32.9	330	–46.3	565	361	11.7	.44	7,003	18.6	8.7
40. Atlantic Richfield	1,303	–70.9	615	84.7	–2,336	–143	11.7	1.66	14,487	9.0	8.2
41. General Dynamics	1,285	117.1	–63	NM	814	132	–5.0	.34	8,892	14.5	2.3
42. Procter & Gamble[4]	1,255	54.4	709	11.7	–285	–924	12.3	.54	15,439	8.1	10.2
43. Santa Fe Southern Pacific	1,242	–0.5	–269	NM	–181	–153	–5.3	.39	5,631	22.1	3.7
44. Phillips Petroleum	1,242	–33.6	234	–60.7	197	175	12.0	2.98	9,786	12.7	2.2
45. Westinghouse Electric	1,218	72.6	671	10.8	543	–83	22.4	.37	10,731	11.4	6.5
46. United Parcel Service	1,182	19.0	669	17.9	184	–375	27.1	.05	8,620	13.7	NA
47. Tenneco	1,181	–30.2	139	–67.8	–434	–661	1.7	1.41	14,529	8.1	4.8
48. Monsanto	1,153	45.6	433	NM	409	–164	11.5	.53	6,879	16.8	3.0
49. Unisys	1,108	84.0	–43	NM	390	9	–3.1	.72	7,432	14.9	3.3
50. General Mills[2]	1,069	726.4	184	59.0	663	–241	26.9	.69	4,587	23.3	3.6

CASH FLOW THE TOP 200

COMPANY	CASH FLOW $Millions '94	CASH FLOW % change vs. '93	NET INCOME $Millions '94	NET INCOME % change vs. '93	DISCRETIONARY CASH FLOW $Millions '94	DISCRETIONARY CASH FLOW $Millions '93	RETURN ON EQUITY %	DEBT TO EQUITY %	REVENUES $Millions	CASH FLOW TO REVENUES %	MARKET VALUE/ CASH FLOW RATIO
51. CSX †	1,014	19.4	418	NM	-179	-651	8.6	.74	6,345	16.0	4.4
52. Hewlett-Packard[3]	1,014	13.8	516	5.5	403	130	11.8	.08	7,102	14.3	10.6
53. Kraft	1,011	37.4	390	-16.3	540	226	21.7	.54	8,742	11.6	6.3
54. Merck	1,000	4.7	676	25.2	509	481	26.3	.21	4,129	24.2	16.9
55. Coca-Cola	973	-7.1	934	37.9	-129	-114	26.6	.49	8,669	11.2	14.9
56. Texas Air	929	302.0	42	-13.1	-40	13	2.3	4.17	4,407	21.1	1.3
57. Anheuser-Busch	914	-0.8	518	16.8	-35	175	22.4	.46	7,677	11.9	7.7
58. Lilly (Eli)	908	57.6	558	7.8	355	122	20.4	.23	3,720	24.4	11.4
59. Southland	905	196.6	200	-5.7	129	-230	12.3	.53	8,187	11.1	2.5
60. McDonald's	878	5.1	480	10.8	-180	-102	19.5	.93	4,144	21.2	8.8
61. United Telecommunications	860	0.0	187	801.2	-319	-433	10.6	1.61	2,857	30.1	2.9
62. Aluminum Co. of America	856	10.5	264	NM	139	87	7.2	.37	4,667	18.3	3.5
63. Waste Management	855	167.9	371	116.2	318	-118	23.5	.30	2,018	42.4	7.0
64. Norfolk Southern	852	-1.3	519	3.7	-187	-193	10.2	.18	4,076	20.9	6.3
65. Grace (W.R.)	847	NM	-375	NM	446	-521	-28.9	.95	3,726	22.7	2.4
66. Lockheed	821	69.5	408	1.8	212	CF	21.9	.86	10,273	8.0	4.0
67. Allied Signal	819	NM	605	NM	-279	-1,096	15.6	.80	11,794	6.9	8.5
68. Contel	812	12.1	233	-2.9	-94	-7	15.5	1.35	3,074	26.4	2.7
69. Ryder System	805	30.6	161	28.4	-223	-244	13.7	1.74	3,768	21.4	3.2
70. Allegis	787	NM	12	NM	-1,066	-1219	0.5	1.39	9,196	8.6	3.3
71. Baxter Travenol Laboratories	786	NM	181	32.1	331	-448	6.4	.53	5,543	14.2	5.3
72. Squibb	785	224.8	264	16.4	584	-72	19.4	.17	1,785	44.0	7.5
73. General Motors Class H	761	NA	594	21.6	-62	NA	8.9	.09	10,372	7.3	0.0
74. MCA	751	-2.9	155	3.5	-126	-98	9.8	.16	2,441	30.8	3.9
75. AMR	746	-16.3	279	-19.3	-1,043	-427	11.3	1.07	6,018	12.4	4.2
76. McDonnell Douglas Corp.	738	69.5	278	-19.7	-8	-219	9.8	.35	12,661	5.8	3.9
77. SmithKline Beckman	733	6.2	521	1.3	CF	CF	40.2	.27	3,745	19.6	8.3
78. Pfizer	732	17.1	660	13.9	263	36	19.5	.16	4,476	16.4	13.8
79. Borden	718	62.7	223	15.2	468	165	15.5	.72	5,002	14.4	4.8
80. Occidental Petroleum	715	-48.4	172	-62.2	-763	-267	2.5	1.94	15,344	4.7	6.3
81. Champion International	706	-2.9	201	23.1	13	80	7.5	.84	4,388	16.1	4.1
82. K mart[3] †	684	-42.0	570	21.0	-177	371	14.5	.76	24,046	2.8	8.6
83. NCR	681	-17.5	337	6.8	215	341	14.0	.08	4,882	13.9	6.1
84. Bristol-Myers	680	7.0	590	10.9	154	170	20.8	.14	4,836	14.1	17.4
85. Motorola	676	71.6	194	169	-18	-411	7.0	.23	5,888	11.5	6.8
86. Abbott Laboratories	675	-0.1	540	16.1	116	234	30.4	.50	3,808	17.7	15.5
87. Penney (J.C.)[3]	673	NM	530	33.5	142	-2,071	12.2	.86	14,740	4.6	8.0
88. Halliburton	646	37.0	-515	NM	391	-94	-24.0	.13	3,527	18.3	4.0
89. American Brands	638	32.5	365	-13.2	136	-40	13.7	.43	5,261	12.1	7.3
90. Dun & Bradstreet	618	62.5	400	15.4	262	13	22.8	.03	3,114	19.9	12.9
91. Pillsbury[2]	601	74.1	208	8.5	179	-142	15.8	.80	5,848	10.3	4.9
92. Navistar International[2]	587	273.6	-2	NM	492	103	NM	14.19	3,357	17.5	0.9
93. Lucky Stores[2]	585	123.1	50	-42.6	251	-82	17.8	1.35	6,441	9.1	1.8
94. Holiday	580	-1.4	103	-26.8	142	52	16.2	1.82	1,648	35.2	2.9
95. Penn Central	573	134.8	154	39.2	415	83	7.4	.05	2,388	24.0	3.7
96. General Motors Class E	568	-13.2	261	37.5	-112	47	32.7	.04	4,321	13.1	5.3
97. Raytheon	566	22.5	393	4.6	79	-19	20.1	.04	7,308	7.7	8.8
98. Martin Marietta	563	11.1	202	-18.9	208	131	24.0	.27	4,753	11.8	3.8
99. FMC	549	40.8	153	-22.4	-1,528	-1	NM	NM	3,003	18.3	2.1
100. Weyerhaeuser	545	-11.3	277	38.3	-283	-221	7.6	.56	5,652	9.6	9.1

CASH FLOW THE TOP 200

COMPANY	CASH FLOW $Millions '86	CASH FLOW % change vs. '85	NET INCOME $Millions '86	NET INCOME % change vs. '85	DISCRETIONARY CASH FLOW $Millions '86	DISCRETIONARY CASH FLOW $Millions '85	RETURN ON EQUITY %	DEBT TO EQUITY %	REVENUES $Millions	CASH FLOW TO REVENUES %	MARKET VALUE/ CASH FLOW RATIO
101. Kellogg	543	20.7	319	13.5	86	90	35.5	.45	3,341	16.3	11.8
102. Consolidated Rail	542	9.2	316	–12.5	–163	–198	17.6	.44	3,144	17.2	NA
103. Honeywell	539	–11.2	13	–95.3	96	11	0.6	.65	5,378	10.0	5.0
104. NWA	530	168.0	77	5.2	–169	–515	7.9	1.68	3,589	14.8	2.8
105. Georgia-Pacific	524	–32.1	296	43.0	–96	–2	11.5	.47	7,223	7.3	7.6
106. Gannett	519	47.7	276	9.1	187	25	19.3	.84	2,802	18.5	11.2
107. Warner-Lambert	518	41.6	309	NM	219	4	34.1	.64	3,103	16.7	8.1
108. Kroger	518	88.7	56	–69.2	–108	–250	5.1	.77	17,123	3.0	4.9
109. Tandy[4]	503	NM	198	4.6	446	–103	15.1	.36	3,036	16.6	7.6
110. Archer-Daniels-Midland[4]	502	40.0	239	46.0	CF	CF	11.5	.28	5,336	9.4	6.0
111. Goodyear Tire & Rubber	500	–54.5	101	–66.6	–1,047	–778	3.4	.94	9,103	5.5	8.1
112. Emerson Electric[7]	498	54.5	409	1.9	132	–88	17.2	.22	4,953	10.1	12.2
113. Pennzoil	497	–4.2	69	–63.6	154	–187	7.6	1.59	1,782	27.9	5.6
114. Federated Dept. Stores[3]	496	–12.8	302	5.3	–176	59	11.3	.39	10,512	4.7	7.8
115. American Cyanamid	494	94.9	203	68.5	136	–51	11.8	.48	3,816	12.9	7.3
116. Time	492	104.6	376	88.2	157	–73	28.9	.73	3,762	13.1	8.6
117. CPC International	486	41.1	219	54.4	–4	–205	22.9	1.61	4,549	10.7	6.7
118. Colgate-Palmolive	480	129.0	177	5.8	133	–125	18.3	.69	4,985	9.6	6.0
119. Sun	479	–77.0	385	–27.0	–1,103	190	7.3	.48	9,376	5.1	12.2
120. TRW †	472	–0.3	218	62.8	–82	–108	18.0	.95	6,036	7.8	5.3
121. CBS	470	–21.7	190	–6.3	144	395	22.0	.69	4,646	10.1	6.4
122. Dayton-Hudson[3]	466	4.7	255	–10.1	–583	–63	11.7	.64	9,259	5.0	8.9
123. Humana[6]	464	54.1	54	–74.8	58	–217	6.1	1.44	2,601	17.9	4.0
124. Cooper Industries	464	NM	148	9.4	266	–305	10.4	.67	3,421	13.6	4.3
125. MCI Communications †	464	–40.0	–431	NM	–1,064	–288	–34.2	2.21	3,592	12.9	3.8
126. PPG Industries	461	–0.1	316	4.5	CF	CF	16.0	.68	4,687	9.8	9.5
127. Marriott	455	12.9	192	14.5	–634	–580	19.3	1.71	5,267	8.7	8.3
128. Ashland Oil[7]	446	11.4	209	42.2	68	–13	20.7	.91	6,991	6.4	4.1
129. International Paper	444	–22.8	305	132.8	–302	–399	7.8	.53	5,500	8.1	8.8
130. Campbell Soup[3]	442	10.7	223	12.8	129	124	14.5	.29	4,379	10.1	8.4
131. Federal Express[3]	439	99.2	132	73.3	CF	–390	12.0	.58	2,606	16.9	7.3
132. American Medical International[6] †	435	4.5	–97	NM	–83	–94	–11.0	2.41	2,488	17.5	3.0
133. Kimberly-Clark	426	–26.9	269	0.9	–7	14	14.0	.29	4,303	9.9	8.6
134. Centel	423	23.7	109	–15.3	80	–24	11.3	1.00	1,370	30.9	3.8
135. Rapid American[3]	418	833.9	–9	NM	259	–181	–35.3	13.03	1,894	22.1	NA
136. Air Products & Chemicals[7]	404	13.6	5	–96.7	–35	–117	0.4	.67	1,982	20.4	5.0
137. Heinz (H.J.)[1]	397	25.9	302	13.4	57	35	22.2	.40	4,366	9.1	13.6
138. Hercules	396	266.0	227	70.3	33	–232	13.5	.36	2,615	15.1	7.0
139. Marsh & McLennan	393	97.8	243	49.3	168	54	38.1	.18	1,804	21.8	11.4
140. Amerada Hess	390	–68.4	–219	NM	91	218	–10.7	.75	4,015	9.7	5.1
141. Borg-Warner	390	–6.4	155	–13.6	–10	78	10.2	.29	3,379	11.5	8.4
142. Wal-Mart Stores[3]	364	–15.4	450	37.4	–282	–153	26.6	.57	11,909	3.1	36.1
143. Upjohn	359	4.0	252	24.3	57	–23	17.2	.34	2,291	15.7	16.2
144. Southern New England Tel.	359	0.5	139	16.1	–20	11	13.4	.65	1,433	25.1	4.6
145. Litton Industries[3]	359	–13.0	71	–76.3	41	73	6.9	1.52	4,521	7.9	5.6
146. Goodrich (B.F.)	349	189.1	13	NM	65	–151	1.5	.59	2,553	13.7	2.8
147. Hospital Corp. of America	347	–34.2	175	–38.5	–350	–309	8.7	1.61	4,931	7.0	7.2
148. Delta Air Lines[4]	347	–51.7	47	–81.8	–314	4	3.6	.71	4,460	7.8	5.6
149. Tribune	346	42.8	293	136.5	148	33	26.6	.48	2,030	17.1	6.5
150. Scott Paper	345	–10.2	187	–7.3	CF	CF	13.8	1.10	3,437	10.0	6.6

CASH FLOW

THE TOP 200

COMPANY	CASH FLOW $Millions '86	CASH FLOW % change vs. '85	NET INCOME $Millions '86	NET INCOME % change vs. '85	DISCRETIONARY CASH FLOW $Millions '86	DISCRETIONARY CASH FLOW $Millions '85	RETURN ON EQUITY %	DEBT TO EQUITY %	REVENUES $Millions	CASH FLOW TO REVENUES %	MARKET VALUE/ CASH FLOW RATIO
151. Warner Communications	342	0.9	164	–16.2	–267	311	13.1	.44	2,848	12.0	8.2
152. Johnson Controls[2]	341	NM	96	22.5	177	–218	10.8	.29	2,639	12.9	3.2
153. Dresser Industries[8]	341	43.0	1	NM	190	–7	0.0	.34	3,661	9.3	4.3
154. Union Camp	338	19.3	130	36.6	31	–55	9.5	.50	2,045	16.5	7.4
155. Textron	336	868.0	242	34.2	63	–231	13.3	1.20	5,023	6.7	7.5
156. Tri Star Pictures	332	NA	14	771.4	331	NA	6.4	.91	254	130.6	0.8
157. American Standard	330	120.9	110	NM	69	–88	13.1	.42	2,998	11.0	4.3
158. Wang Laboratories Class B[4]	329	64.8	51	228.4	59	–244	3.5	.50	2,643	12.4	5.3
159. Times Mirror	328	–23.8	408	72.1	–216	–50	31.4	.69	2,920	11.3	12.5
160. Wickes[3]	322	NM	74	163.2	4	–729	5.3	2.24	4,770	6.8	2.6
161. Maxus Energy	321	–50.7	–196	NM	–166	–175	–15.4	.82	2,513	12.8	4.2
162. Combustion Engineering	321	NM	56	NM	188	–243	8.2	.23	2,551	12.6	3.2
163. Schering-Plough	320	18.6	266	38.0	80	–34	18.2	.62	2,399	13.4	14.4
164. Woolworth (F.W.)[3]	318	10.4	214	20.9	28	21	14.4	.25	6,244	5.1	8.0
165. Lone Star Industries	317	65.5	117	115.4	192	CF	17.8	.65	883	35.9	1.5
166. Kerr-McGee	316	–58.3	–292	NM	–92	171	–21.8	.60	2,535	12.5	4.3
167. Apple Computer[7]	315	25.0	154	151.5	249	198	22.2	.00	1,902	16.6	8.1
168. Sara Lee[4]	311	–39.2	223	8.3	–20	161	19.0	.61	7,938	3.9	11.6
169. USG	310	–12.8	255	14.1	9	132	43.7	1.47	2,724	11.4	6.4
170. Rohm & Hass	307	7.8	138	–2.1	34	25	13.8	.39	2,067	14.9	7.8
171. American Stores[3]	305	2.4	145	–6.4	30	1	14.2	.96	14,022	2.2	5.5
172. AMP	305	28.6	164	52.2	60	–69	14.5	.17	1,933	15.8	12.8
173. Melville	303	–3.9	238	8.4	71	131	18.9	.06	5,262	5.8	9.7
174. Westvaco[8]	300	56.3	108	3.3	5	–185	10.0	.48	1,812	16.5	5.9
175. Koppers	291	NM	63	NM	56	–140	12.5	.27	1,396	20.9	2.9
176. Pitney-Bowes †	290	27.9	166	14.9	18	–24	18.4	.27	1,987	14.6	9.7
177. Bally Mfg.	290	49.5	24	–7.6	82	–35	4.8	2.66	1,593	18.2	2.1
178. Knight-Ridder	289	27.3	140	5.5	92	73	17.2	.82	1,911	15.2	9.3
179. USAir	289	21.5	98	–16.0	–46	–111	10.0	.43	1,835	15.7	3.4
180. Dow Jones	287	25.5	183	32.3	160	19	25.2	.08	1,135	25.3	13.1
181. Great Northern Nekoosa	287	81.2	85	84.6	90	–3	8.1	.41	2,039	14.1	6.0
182. Burlington Industries[7]	287	8.4	57	349.6	53	28	5.0	.41	2,778	10.3	4.0
183. Limited[3]	283	22.5	228	56.8	54	30	29.2	.09	3,143	9.0	21.2
184. Louisiana Land & Exploration	274	–33.3	–21	NM	88	80	–3.4	1.07	793	34.6	3.1
185. Sterling Drug	272	52.5	172	11.9	98	26	17.6	.36	1,990	13.7	10.0
186. Boise Cascade	270	–13.3	102	–2.6	–242	–113	6.4	.77	3,740	7.2	6.4
187. Minstar	269	NM	–1	NM	149	–396	–0.6	2.89	990	27.2	1.4
188. GenCorp[9]	267	28.7	130	166.7	29	4	12.4	.24	3,099	8.6	6.2
189. Quaker Oats[4]	267	10.7	174	11.2	40	75	20.7	.56	3,671	7.3	11.7
190. Cabot[8]	265	70.7	73	2.5	152	–30	12.4	.79	1,310	20.2	3.2
191. Ingersoll-Rand	264	137.0	101	26.5	92	–116	9.0	.45	2,799	9.4	4.2
192. Manville	261	49.9	81	NM	123	9	5.8	.09	1,920	13.6	0.2
193. New York Times Class A	259	36.5	132	13.7	122	53	18.7	.36	1,565	16.6	11.2
194. Corning Glass Works	256	9.3	162	50.7	CF	CF	12.0	.26	1,856	13.8	9.6
195. James River[1]	251	102.0	95	–6.0	–59	–118	11.8	.87	2,607	9.6	7.0
196. Alltel	246	25.0	56	–20.5	12	–34	10.3	1.17	697	35.3	3.5
197. Murphy Oil	245	–9.0	–195	NM	51	–49	–25.1	.37	1,313	18.7	3.4
198. Ralston Purina[7]	244	–55.1	264	2.8	–47	207	26.4	2.12	5,515	4.4	22.1
199. Winn-Dixie Stores[4]	242	–2.3	116	7.9	–20	14	16.5	.17	8,225	2.9	7.8
200. Firestone Tire & Rubber [8]	241	129.5	3	NM	–29	–199	0.3	.27	3,501	6.9	4.5

ALPHABETICAL RANKING—CASH FLOW: THE TOP 200

The company ranking appears in boldface for 1986 and in lightface for 1985.

COMPANY	Rank '86	'85
AMP	172	182
AMR	75	50
AT&T	4	5
Abbott Laboratories	86	73
Air Products & Chemicals	136	131
Allegis	70	
Allied Signal	67	
Alltel	196	
Aluminium Co. of America	62	61
Amerada Hess	140	36
American Brands	89	99
American Cyanamid	115	168
American Home Products	33	58
American Info. Tech.	14	14
American Medical Int'l.	132	111
American Standard	157	
American Stores	171	149
Amoco	19	7
Anheuser-Busch	57	48
Apple Computer	167	170
Archer-Daniels-Midland	110	127
Ashland Oil	128	116
Atlantic Richfield	40	9
Bally	177	
Baxter Travenol	71	
Bell Atlantic	12	15
BellSouth	7	13
Boeing	24	19
Boise Cascade	186	145
Borden	79	106
Borg-Warner	141	110
Bristol-Myers	84	78
Burlington Inds.	162	162
Burlington Northern	38	30
CBS	121	85
CPC Int'l.	117	135
CSX	51	53
Cabot	190	
Campbell Soup	130	117
Centel	134	137
Champion Int'l.	81	67
Chevron	6	4
Chrysler	18	18
Coca-Cola	55	42
Colgate-Palmolive	118	
Combustion Engineering	162	
Consolidated Rail	102	
Contel	68	68
Cooper Inds.	124	
Corning Glass	194	184
Dayton-Hudson	122	105
Delta Air Lines	148	69
Digital Equipment	35	77
Dow Chemical	31	70
Dow Jones	180	191
Dresser Inds.	153	180
Du Pont (E.I.)	11	11
Dun & Bradstreet	90	122
Eastman Kodak	36	43
Emerson Electric	112	140
Exxon	3	1
FMC	99	119
Federal Express	131	195
Federated Dept. Stores	114	91
Firestone Tire & Rubber	200	
Ford Motor	2	6
GTE	9	12
Gannett	106	132
GenCorp	188	200
General Dynamics	41	86
General Electric	16	20
General Mills	50	
General Motors	5	2
General Motors (Class E)	96	75
General Motors (Class H)	73	
Georgia-Pacific	105	64
Goodrich (B.F.)	146	
Goodyear Tire & Rubber	111	40
Grace (W.R.)	65	
Great Northern Nekoosa	181	
Halliburton	88	101
Heinz (H.J.)	137	144
Hercules	138	
Hewlett-Packard	52	51
Holiday	94	87
Honeywell	103	83
Hospital Corp. of America	147	93
Humana	123	148
ITT	23	32
Ingersoll-Rand	191	
Int'l. Business Machines	1	3
Int'l. Paper	129	90
James River	195	
Johnson & Johnson	39	45
Johnson Controls	152	
Kellogg	101	104
Kerr-McGee	166	65
Kimberly-Clark	133	88
K mart	82	39
Knight-Ridder	178	192
Koppers	175	
Kraft	53	
Kroger	108	158
Lilly (Eli)	58	89
Limited	183	187
Litton Inds.	145	112
Lockheed	66	98
Lone Star Inds.	165	
Louisiana Land & Expl.	184	113
Lucky Stores	93	164
MCA	74	62
MCI Communications	125	63
Manville	192	
Marriott	127	114
Marsh & McLennan	139	
Martin Marietta	98	96
Maxus Energy	161	
McDonald's	60	55
McDonnell Douglas	76	107
Melville	173	142
Merck	54	47
Minn. Mining & Mfg.	32	38
Minstar	187	
Mobil	10	10
Monsanto	48	60
Motorola	85	118
Murphy Oil	197	161
NCR	83	56
NWA	104	
Navistar Int'l.	92	
New York Times (Class A)	193	
Norfolk Southern	64	37
NYNEX	15	17
Occidental Petroleum	80	31
PPG Inds.	126	103
Pacific Telesis	13	22
Penn Central	95	174
Penney (J.C.)	87	
Pennzoil	113	94
PepsiCo	27	80
Pfizer	78	79
Philip Morris	22	41
Phillips Petroleum	44	25
Pillsbury	91	134
Pitney-Bowes	176	194
Procter & Gamble	42	59
Quaker Oats	189	177
RJR Nabisco	17	29
Ralston Purina	198	92
Rapid-American	135	
Raytheon	97	102
Rockwell Int'l.	37	49
Rohm & Haas	170	155
Ryder System	69	81
Santa Fe Southern Pacific	43	35
Sara Lee	168	95
Schering-Plough	163	160
Scott Paper	150	121
SmithKline Beckman	77	72
Southern New Eng. Tel.	144	128
Southland	59	147
Southwestern Bell	20	21
Squibb	72	176
Standard Oil	25	16
Sterling Drug	185	
Sun	119	24
TRW	120	100
Tandy	109	
Tenneco	47	26
Texaco	8	8
Texas Air	56	186
Textron	155	
Time	116	178
Times Mirror	159	108
Tribune	149	175
Tri Star Pictures	156	
USX	26	
USG	169	129
Union Camp	154	156
Union Carbide	34	
Union Pacific	29	33
Unisys	49	
United Parcel Service	46	44
USAir	179	180
US West	21	23
United Telecommunications	61	46
Unocal	30	28
Upjohn	143	133
Wal-Mart	142	109
Wang Laboratories	158	
Warner Communications	151	138
Warner-Lambert	107	126
Waste Management	63	141
Westinghouse Electric	45	71
Westvaco	174	
Weyerhaeuser	100	82
Wickes	160	
Winn-Dixie	199	172
Woolworth (F.W.)	164	152
Xerox	28	27

DEFINITIONS AND FOOTNOTES

Definitions:

Cash flow from operations was derived from the following formula: net income (not including extraordinary items) adjusted to remove expenses not requiring cash (depreciation and deferred taxes) and income not generating cash (unremitted earnings from unconsolidated subsidiaries) and also adjusted for changes from the prior year in current receivables, other current assets other than cash and cash equivalents, current accounts payable, income taxes payable and other current liabilities other than notes payable and debt due within one year.

–Percentage change in cash flow from operations is current cash flow divided by the prior year's cash flow.

–Discretionary cash flow from operations is cash flow from operations minus capital expenditures, total dividends and debt due in one year as reported in prior year's statement.

–Return on common equity is net income available for common shareholders divided by common equity—that is, common stock plus capital surplus and retained earnings.

–Debt as a percentage of equity is the ratio of total debt to total equity. It is calculated by taking long-term debt plus the portion of long-term debt due in one year plus notes payable and dividing the total by total shareholder equity (preferred stock plus common stock, capital surplus and retained earnings).

–The market value/cash flow ratio is arrived at by multiplying the number of shares outstanding on December 31, 1986 with the share price of that day and then dividing that result by the cash flow.

Abbreviations:

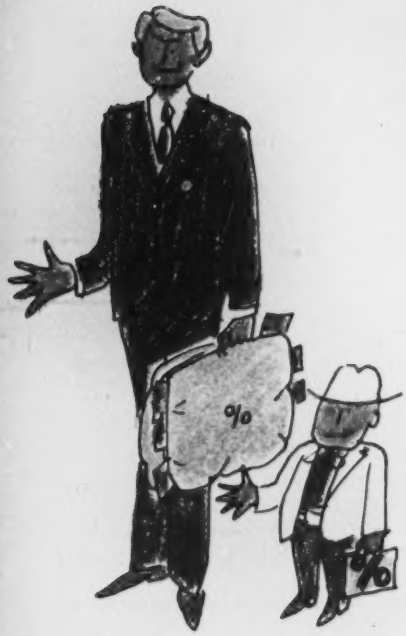
cf: combined figure (calculation cannot be done because the company did not report individual items). *nm:* not meaningful (equation contains one or more negative numbers). *nr:* not reported (item required to do calculation was not reported). *na:* not available.

Footnotes:

1. Fiscal year ended April 30, 1985. 2. Fiscal year ended May 31, 1985. 3. Fiscal year ended January 31, 1986. 4. Fiscal year ended June 30, 1986. 5. Fiscal year ended July 31, 1986. 6. Fiscal year ended August 31, 1985. 7. Fiscal year ended September 30, 1986. 8. Fiscal year ended October 31, 1986. 9. Fiscal year ended November 30, 1986. † The net income reported by these companies includes items that are normally excluded in our calculations.

Source:

–The study is drawn from the Standard & Poor's Compustat data base of 6,400 companies from which were eliminated financial companies (savings and loans, banks, insurance companies, securities firms and finance companies), as well as companies with more than 50% of profits from finance subsidiaries of domestic companies and regulated gas and electric utilities.



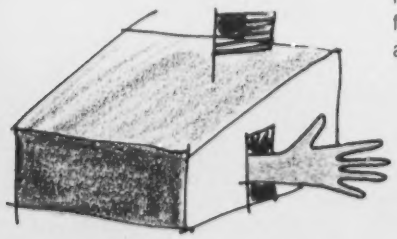
New Financial Products, More Competition Good News for Corporate Treasurers

Money center banks, investment bankers, insurers, overseas sources cutting into local and regional bankers

A decade ago, a $35 million company with no credit rating seeking a $25 million loan might have pleaded with every bank in its region with no success. If it had been successful, it's a safe bet that it would have been forced to pay a rate significantly above the prime.

Contrast that with the experience of Xyvision Inc., a tiny, but rapidly growing company in the desktop publishing business. In April, it raised $25 million by issuing convertible Eurobonds. Although it didn't have an immediate need for cash, the terms were too good to pass up.

Not only did Xyvision get a favorable 6% rate on the financing, but the Wakefield, Massachusetts, company, which



went public only a year ago, was courted by some of the top names in commercial and investment banking, all of them eager for its business. The financing was underwritten by Credit Suisse/First Boston Corp., one of the biggest international investment bankers, and Montgomery Securities.

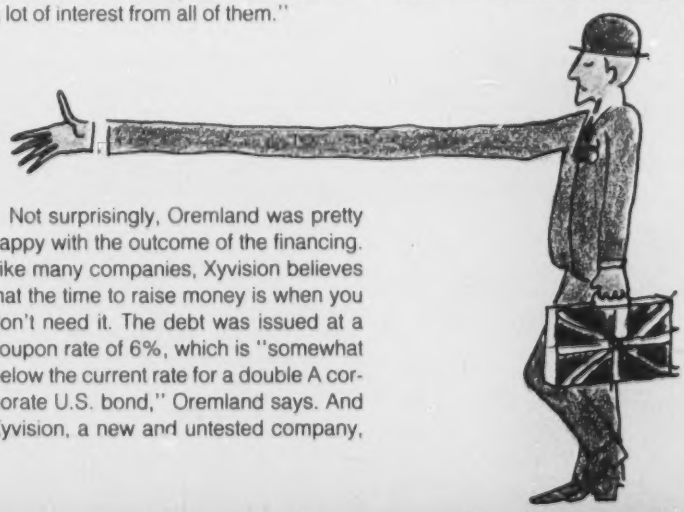
As the Xyvision financing illustrates, the corporate banking and finance marketplace has become a global one. The largest corporations have enjoyed great flexibility in financing for some time. Now the same opportunities are filtering down to smaller and smaller companies.

The so-called "middle market" companies are no longer dependent solely on their local bank or even a regional bank for credit, for counsel or for cash management services. If they don't like what the banks offer, they can go to London. And, the top investment banking firms and commercial banks are in fierce competition for these small and medium-sized companies. In fact, when Xyvision went public in July 1986, "We spoke with most of the major investment banking firms," says Steven Oremland, chief financial officer of Xyvision. "There was a lot of interest from all of them."

Not surprisingly, Oremland was pretty happy with the outcome of the financing. Like many companies, Xyvision believes that the time to raise money is when you don't need it. The debt was issued at a coupon rate of 6%, which is "somewhat below the current rate for a double A corporate U.S. bond," Oremland says. And Xyvision, a new and untested company, obviously could not get a double A rating. "The coupon rate is also below what we're able to earn with conservative investments of our cash," he explains. "So the burden of the financing was close to negligible."

Further, the debt was convertible to equity at a 25% premium over the stock's trading price. "So whether we viewed it as a debt financing or an equity financing, it was a very good deal," he concludes.

This hot competition to provide corporate banking and finance services to companies across the spectrum is good news for corporate treasurers who, like Oremland, are now likely to be wooed by more and bigger players proffering a larger array of products than ever before. It means that banks and investment banks have pared profit margins to offer



new and cheaper products for both credit and cash management needs. In addition, some insurance companies are entering the fray with an extension of their traditional real estate lending to include new types of loan products.

By the same token, more is expected of the corporate treasurer. "The treasury function is really starting to show its strength in dealing with financial institutions," says Laurence Pettit, banking professor at the University of Virginia. "The corporate officer in charge is really running a profit center. He's got to do something about lowering his costs and getting the most bang for his buck, where before there was a tendency to just look for a comfortable relationship and not be too concerned about it."

Pettit adds that treasurers used to talk about getting money at maybe 7%, 8% or 9%. Today, there's no such sloppiness. "Now, we hear things like 7.893 percent," he says. "The treasurer is in the middle and he knows he has to provide money at the lowest possible cost." And, those who do business with middle market companies add, treasurers at these small and medium sized firms have become increasingly sophisticated. No matter if the product is asset-based financing or currency swaps, these clients are apparently a match for their bankers.

Companies Using More Banks

Size	Av. No of Banks Used in:	1982	1983	1984	1985	1986
1-100		4.8	5.6	4.5	5.7	7.1
101-200		3.5	3.6	3.6	3.6	4.3
201-300		3.9	2.9	2.9	3.3	3.5
301-400		2.9	2.5	2.4	3.1	3.0
401-500		2.6	2.2	1.8	1.8	2.4
Total Industrials		3.2	2.8	2.8	3.1	3.7

A Look at the Key New Credit Service Products

Raising money has probably never been easier or cheaper. A host of players is vying for the corporate treasurer's business—each of them devising new products to help him or her do the job better and more quickly. "Today, Triple A credits can borrow directly from the public and access long-term debt markets domestically and internationally," says John A. Canning Jr., executive vice president and corporate partner at First National Bank of Chicago. "The market is now a quasi-public market where there is the ability of companies to raise money in a very easy fashion."

Here are some examples of what's happening:

■ *Commercial bankers are moving assets off the balance sheet by packaging or "securitizing" them so they can do more business and reduce risk.* In some cases, loans are pooled and interests in the pool of loans are sold as securities to investors.

While banks like loan sales, there are indications that commercial customers are not as happy with this new technique. A corporate banking study by Greenwich Associates, a Greenwich, Connecticut-based research firm, found that 41% of large corporations have some objection to this practice. Nearly 60% of those who objected disliked the loss of a principal relationship with the bank. Three other potential drawbacks cited by more than half of the large corporations were: loss of flexibility; loss of confidentiality; and loss of control. The study found that smaller borrowers were most concerned about loss of a relationship, while larger borrowers worried that the securities derived from the loans would compete in the marketplace with their own commercial paper.

■ *Investment bankers stand ready to provide bridge loans to do an entire financing.* "They'll put their balance sheet at risk for the whole thing and then turn around and use their distribution capability to get it off their books," Canning says.

■ *The junk bond market has grown from almost nothing to $100 billion in four or five years time.* A recent study by Drexel Burnham Lambert found that among 23,000 U.S. companies with sales of at least $25 million, fewer than 800 had investment grade ratings. The others now have a new source of financing through junk bonds.

■ *Insurers are expanding from their traditional base of real estate lending.*

Treasurers have been quick to take advantage of this wide open marketplace. And, in many cases, what it has meant is a loss of market share for commercial banks. For example, in an effort to cut their banking fees, many corporations no longer maintain a relationship with a lead bank. A lead bank, or agent bank, deals for the corporation in the marketplace, charging an agency fee to line up other lenders. Many corporations have decided to eliminate that costly service by dealing in the market themselves, picking and choosing the exact services they want.

The Greenwich study found that, increasingly, large corporations do business based on the cost of a single transaction rather than their relationship with a bank. Nearly two thirds of the corporations surveyed in the 1986 study said their relationships with banks had changed over the past five years. Many companies are concentrating their relationships with fewer banks. They're also paying their bankers less.

Investment bankers have some clear advantages in this competition for the treasurer's business. "The commercial banker always has to look at the long term and try to figure out when this money will be paid back," says Laurence Pettit, banking professor at the University of Virginia. "The investment banker doesn't have to worry about that. He can simply sell the transaction."

To compete, banks not only will have to get bigger and stronger, but leaner and meaner, Pettit says. "They're going to have to produce more. They're going

to have to earn more per employee than in the past, which means selling more bank services through each employee." And they must become better at offering the whole range of services. "They have to stop thinking in terms of 'How much money can I loan you?' and think about: 'What can I do to assist you financially in anything from swaps to a private placement or back to the old standbys of cash management and lines of credit?' " The old style inaction that forced bank clients to wait three weeks to find out about a loan approval is "gone forever," Pettit says. "They must be ready to act on their customer's needs because there's someone else waiting out there."

Greenwich Associates found that commercial banks are working hard to sell investment banking services, especially interest rate swaps, currency swaps, bankers acceptances, Euronote issues and Eurobond issues.

The swap market, which is only about five years old, has exploded, according to the International Swap Dealers Association, the trade group that is working to standardize the trades. In an interest rate swap, two institutions agree to trade floating rate payments for fixed rate debt to fit better with their own obligations. While this was considered an arcane financing area only a few years ago, ISDA estimates current volume at about $400 billion a year.

Both commercial and investment bankers are active players in this rapidly growing market. In March, ISDA completed development of a master agreement that it hopes will both reduce costs for players in the marketplace and also decrease legal fees, fueling even more rapid market growth and bringing in smaller size players. "The master agreement should help simplify what has been up to now a relatively complex process of documenting these deals and should make the process more efficient and less costly," says Mark Brickell, vice president in the international financial management department at Morgan in New York. "Perhaps most important, it should accelerate the ability for netting of contracts against each other when multiple swap agreements exist."

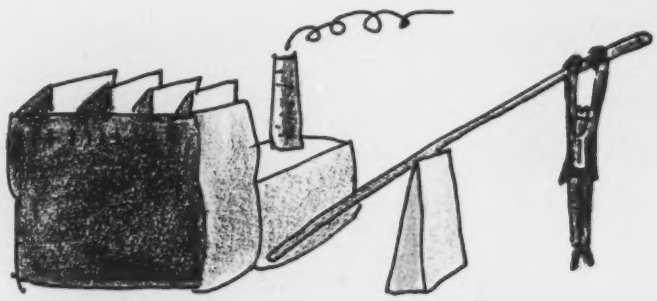
One thing that may affect banks' ability to compete in this marketplace is an expected crackdown by regulators, according to Malcolm T. Murray Jr., president of Robert Morris Associates and executive vice president of First Union National Bank in Charlotte, N.C. Because banks have created so many new off-balance sheet products in their effort to compete with investment bankers, Murray expects a backlash from regulators, probably by yearend.

"As we have gone through the explosion of off-balance sheet kinds of risk, they have not been captured by our historic balance sheet monitoring systems," Murray says. "Whether it's floating rate notes, standby letters of credit or swaps, all of those represent assurances to corporate customers of future funding capacity, future risk absorption or both. Now, we see regulators actively gathering up those off balance sheet items so they will have a regulatory tool to use with the banks." As a result, regulators "will require banks to constrain their activity in these areas," he says.

One area where there is not much competition is jumbo asset-based financing deals, according to one of the major players in this market, who asked not to be identified. Like other markets, it's become more of a transaction than a relationship business, he says. But, because borrowers prefer only one lender at the close, there are only seven players that can handle the really big deals: Bank of Boston, GE, Bankers Trust, Citicorp, Wells Fargo, Heller and Security Pacific.

In the broader area of asset-based lending, observers say there seems to be a leveling off of activity in Leveraged Buy Outs. They attribute it to the fact that, with the rise in the stock market, companies cost more. Many of the deals are therefore being done in layers with more lenders at the close and a number of equity funds and mezzanine funds.

Rather than LBOs, some companies are turning to an Initial Public Offering for a subsidiary or different types of restructurings. One lender in this market argues that subsidiary spinoffs, however they are achieved, have proven that small companies can operate more efficiently than conglomerates and that this fact alone will assure that there will continue to be financing available for them as well as for the big players.



Due to high stock prices, LBOs are being done in layers with more lenders

Credit Market Aboil For Smaller Companies

While competition is heavy in all sectors of corporate banking and finance, investment and commercial bankers and insurers know that the largest companies have squeezed their profit margins to the bone. So, the biggest players have turned to the small and medium sized companies with potential to grow.

An indication of the availability of credit to medium-sized companies was evident in a recent study by Harris Trust and Savings Bank in Chicago. The bank surveyed 588 firms with annual sales of $10 million to $250 million. These businesses cited the availability of local credit as the most beneficial factor for business growth. In fact, 54% rated the willingness of local lenders to provide needed capital as the most advantageous future business factor.

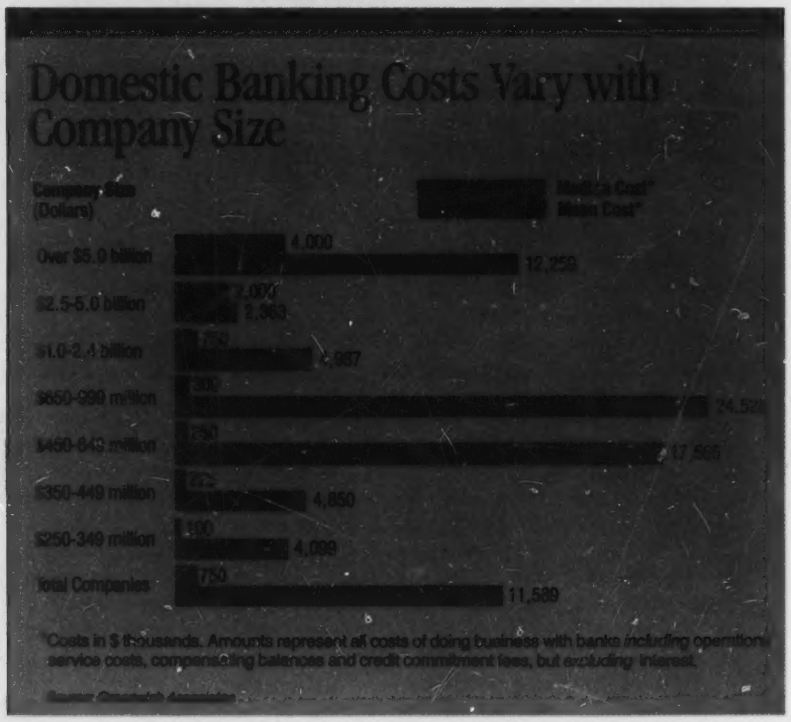
Why is everyone rushing to raise money for these companies? Most importantly, there's more money to be made from smaller companies. Smaller companies pay significantly more for corporate banking services than do larger companies, according to a 1987 study by Greenwich Associates. The spread ranges from 48 basis points among the largest companies to 72 basis points among the smallest.

"The typical middle market borrower pays 54 basis points over the prime rate," the study says. Twenty-one percent borrow at prime and over 5% get money at a discount to the prime.

Apparently, there's some ferment in this marketplace, too. More than a third of these companies concentrate their business with just one bank. But there are indications that many are looking for better service. During the past year, 20% had taken steps to improve bank relationships and even more planned to take action during the next 12 months. And they have plenty of alternatives. The study found that the typical middle market company is being courted by four banks, including two that are seeking new business.

And there are indications that the middle market companies loyalty to regional banks is eroding slightly. The Harris Bank survey found that 52% of the firms surveyed in Chicago would choose one of the major Chicago banks to finance a merger or acquisition, while 21% preferred a suburban Chicago bank. But 18% said they preferred an investment banker, and 10% would go outside Illinois for a banker.

Investment bankers are succeeding in penetrating the middle market in other ways as well. Nearly half of the middle market companies use one or more investment banking services, the Greenwich study found. Two services used by nearly 20% of companies surveyed: pollution control or industrial revenue financing and major equipment leasing.



Similarly, interest rate swaps are being made available to smaller and smaller companies; according to Malcom T. Murray Jr., president of Robert Morris Associates, a group of commercial lending officers. "Initially banks were intermediaries and the players had to be large," he says. "But now, they take a large swap on one side and match it up with many smaller swaps on the other."

At Manufacturers Hanover, the bank can set up swaps for smaller customers because the bank looks at swaps as a book rather than a process of pairing up customers to each side of every deal, according to William Schwartz, vice president on the swap desk. "We don't have to match every little $5 million deal to another deal," he says. "We're looking at a dynamic book. So the minimum size has come down substantially." He adds, "This is no longer a product just for the Fortune 500. This is middle market; a product for $50 million companies."

Schwartz says there is still a substantial amount of back office and legal work involved in each deal and that the fees associated with that might make it prohibitive for a player who is too small. "So a small deal has to carry a little more overhead," he says, "maybe 3-to-5 basis points."

But, Schwartz says, "Three years ago, we would not have contemplated a swap under $25 million in principal. The average size of our swap today is well under $25 million, so that means we're doing plenty of $5 and $10 million swaps. In fact, we've done a $1 million swap."

The middle market players have become much more sophisticated as well, Schwartz says. "I am absolutely amazed when I talk with customers who have never done one of these before and they say to me: 'What is the spread on that?' " he says. "And I'm talking about middle market companies. I don't have to draw charts, arrows or the like."

In the past, although big corporations had credit lines, smaller companies didn't have the clout to get them. But that's changing, too. The Greenwich study found that nearly 75% of the middle market company are using confirmed lines of credit this year, up from 53% in 1985. More than 40% use three additional credit services: guaranteed or standby letters of credit (used by 51% this year, up from 28% in 1985); unconfirmed lines of credit (used by 42%, up from 23%); and unsecured revolving credit.

Loan commitments are just as important to these companies as they are to the giants. "Customers without commitments face considerable uncertainty about both the cost and availability of funds," according to a piece written by Mitchell Berlin, economist for the Federal Reserve Bank of Philadelphia, in that bank's publication, *Business Review*.

During the interest rate volatility of the 1970s and 1980s, the bigger markup and the greater risk of unavailability of

credit made these commitments more valuable to customers, the economist says. And, Berlin continues, they're good for banks too. "Banks can take advantage of customers' willingness to pay for the insurance a loan commitment offers. The most common form of payment, a fee based on the unborrowed balance of the commitment, is especially attractive to banks seeking a stable source of income in an uncertain environment."

Likewise, it discovered that smaller businesses lose investment potential by leaving excess earned income in compensating balances. The WCMA was developed for businesses with sales below $50 million. "Although businesses of this size can certainly benefit from better cash management, they haven't had the clout to demand sophisticated cash management and credit services," says J. Arthur Urciuoli, senior vice president/director of business financial services.

Interest rate swaps: more common

Most observers agree that small and medium-size companies are profiting from this new competition to win their business. "The profit margins are uniformly being driven out of these products," says one. But Murray adds a note of caution: "One should be sure that the company understands all the potential negatives. There could be some pretty significant complications. With these new-found opportunities come a new set of rules and potential complications."

In the past, middle market companies have been accustomed to great flexibility with their banks and they relied on their bankers for a good deal of financial advice, Murray says. When they begin playing on larger courts, they lose flexibility. "Now they find that these products are transaction-driven. They are stand-alone products," he says. "They either have high prepayment costs or they are simply inflexible."

Similarly, with loan sales and securitization, Murray says, "The middle market borrower may find that while he has been accustomed to the flexibility of working with his bank, once the loan is done, he will lose that flexibility."

Be that as it may, it seems a certainty that as the treasurers of smaller companies grow more sophisticated and entertain more suitors looking for their business and offering lower fees, they're bound to consider the options.

Cash Management Now Much More Sophisticated

Cash management services, once pretty ho-hum endeavors used as loss leaders to get customers in the door, have become the battleground for a push-and-pull relationship between bankers and their clients.

The volatile interest rates of the early 1980s forced treasurers to focus their attention on cash flow, says Stephen J. MacQuarrie, division executive of cash management at the Bank of Boston: "Things that weren't worth doing to your cash at 6% were worth doing at 15% or 20% and that really drove cash management services."

But just as companies were getting into the swing of managing their cash flow to eke out every bit of extra interest, rates plummeted in 1983. At the same time, bankers, operating in a deregulated environment, decided they couldn't give these services away anymore, MacQuarrie says.

"Banks had been looking at cash management as an adjunct to their credit business," he explains. "But as the credit business got much tighter, they started treating it like a real business, which meant they started charging more." Rates zoomed for the first half of this decade, increasing an average of 14% a year, according to Treasury Strategies Inc., a company that compiles a market basket of sorts on such things.

"So the companies were caught in a squeeze," MacQuarrie continues. "Money wasn't worth 15% anymore. It was worth 8%. And the cash management services today cost you twice what they did in 1980." Under the circumstances, "a lot of people thought companies would cut back on cash management services," he concludes.

But they didn't. Instead, they started looking to see what things they could do within their own offices to manage their cash flow and they began to scrutinize bank fees closely. A 1986 cash management survey by Greenwich Associates found that the number of executives looking for the best price had increased 15% since 1982 ... to 45% of those polled.

They've managed to hold down price increases, too. Treasury Strategies recently reported that corporate cash management fees rose only 4.5% in 1986. However, according to a recent report in *American Banker*, compensating balance requirements—the money corporations are required to keep in noninterest-bearing accounts in order to get free cash management services—were up by a steep 35.2%.

Cash management price increases varied greatly by product and region, *American Banker* reported. The highest increase—5.9%—was in the Middle Atlantic region, followed by 5.6% in the West. Lowest increases were 1.8% in the Southeast; 2.9% in the Southwest.

When banks reexamined the cash management business, they found it had some attractive features, MacQuarrie notes. Unlike the credit business, which can be risky and cyclical, cash management offers a steady stream of revenue. Because everyone suddenly wanted in, it became very competitive, and banks began trying to develop new products.

Unfortunately, it's not been easy, MacQuarrie says. "It's largely a mature business," he says. "Most attempts at new product development have failed. There is lots of room for product enhancements, but not for brand new ones."

Many of the big banks, therefore, are concentrating on becoming high-quality

producers, on smarter marketing, on identifying target markets and products and on becoming low-cost producers. "The reason costs have not gone up so much lately is because bankers think they've hit the ceiling," MacQuarrie says.

And corporations are changing their techniques. The Greenwich study found that nearly 90% of large companies made changes in their cash management operations in 1986. Nearly 40% of them had started using microcomputers. Other common changes included reviewing the costs of services, switching from compensating balances to fees and increasing the number of services used. Likewise, 80% expected to make additional changes this year. One of the study's conclusions was that "the role of aggressive non-credit service-pricing is clearly more important in using a bank than it was five years ago."

Further, the survey found that the typical company uses eight of the top 50 cash management banks for cash management services and that it is solicited by nearly six additional banks trying to win business.

Very few of the firms surveyed operate without computers. In fact, 96% of the companies get some kind of computerized cash management information and all of them receive it on a terminal in the cash management executive's office. "The focus of much of this has to do with converting transactions to electronics or using computers to facilitate the management of the cash," MacQuarrie says.

Here are the six types of information they receive most frequently by terminal: wire transfers within past 24 hours in system; previous day report of debits, credits and balances by bank; current day report of debits, credits and balances by bank; target balances by bank; float detail; lock box receipts.

More than 80% of these executives initiate commands to their banks on the terminal. In addition to funds transfers, they issue commercial paper and initiate stop-payment commands. One of the things many anticipate doing soon is initiating letters of credit.

MacQuarrie also cites increasing use of the Automated Clearing House. An obvious use is for direct deposit of payroll checks. But he says some companies, such as General Motors, are working on a system to take all of the paperwork out of dealing with suppliers by using the ACH for the whole process from ordering through invoicing and payment.

And, he doesn't expect cash management fees to explode again like they did early in the decade. "There is a lot of supply chasing a smaller amount of demand," he says. "Banks are deathly afraid of pricing themselves out."

Use of Investment Banking Services

Five different investment banking services were used by at least 25% of industrial corporations surveyed last year:

1. Advice on mergers and acquisitions
2. Commercial paper issue
3. Advice on takeover defense
4. Execution of divestiture
5. Valuation study for fee

Source: Greenwich Associates

New Allure in Leasing Despite Loss of ITC

When accountants and other experts were sorting through the fine print of the Tax Reform Act of 1986 to try to identify the winners and losers, leasing companies looked like losers.

That's because the leasing business was set up to take advantage of the Investment Tax Credit and rapid depreciation by passing these deductions from those companies that didn't need the writedowns to those that did. With the loss of the ITC and a slowdown in depreciation, the reasoning went, leasing companies might have to hike their prices, and more companies might decide to buy rather than lease.

As it turns out, though, once those same accountants started digging, they found that leasing might save some companies millions, or even billions, of dollars. The case for leasing pivots on the new Alternative Minimum Tax. The purpose of the AMT was to make certain that all corporations pay some tax. To accomplish this, it mandates that corporations pay tax on the difference between "book" income, or that income reported to shareholders and income reported to the IRS. The AMT amounts to 20% on half the difference.

Quite naturally, companies are eager to put their best foot forward with shareholders. One of the ways they've done this is to use straight line depreciation for book income, giving that income an upfront boost. For the IRS, on the other hand, they choose accelerated depreciation because it lowers current income and, therefore, current taxes.

But under the new tax code, using accelerated depreciation for tax purposes could trigger the AMT. If using accelerated depreciation makes a company subject to the AMT, it must refigure depreciation using a slower method. So, the AMT significantly increases the aftertax cost of acquiring equipment. Lease rental payments, on the other hand, are an ordinary expense item. they do not require an AMT adjustment and they will not alter the relationship between book income and tax income.

According to the American Association of Equipment Lessors, a trade group, Price Waterhouse has done some computer simulations that demonstrate the advantage of leasing for an equipment user subject to the AMT system. They show that a company acquiring computers or general industrial machinery would pay about 3% less in equipment cost by leasing rather than buying equipment.

The advantage of leasing will apply to virtually all companies, according to the association. "It's going to cut across everything," according to Bernard J. McKenna, association chairman. "The AMT applies to virtually all companies not paying the full statutory rate of 34%."

Credits: This Focus Report was written by Mary Rowland, who is a frequent contributor to BUSINESS MONTH. Most recently, she was responsible for the May issue's appraisal of Bond Funds. A former editor at *Financial World*, her articles have appeared in *Fortune, Inc., USA Today, Savvy* and *Working Woman*.
Design: Kedner & Osburn, Inc.

vestment return fluctuate according to how well (or poorly) the insurance company invests your money. You choose the investment vehicle from a handful of stock, bond and mutual fund choices offered by the company; they do the investing.

Sounds great. But there are some important drawbacks to SPL policies that enthusiastic salespeople tend to play down, or don't mention at all. Here are some of the red flags:

Restricted liquidity. Yes, you can borrow—in effect, withdraw—most of your principal and earnings tax-free. In that sense, an SPL is more liquid than an Individual Retirement Account or annuity. But you must pay interest for the privilege, albeit at a low rate. And any loans still outstanding will be subtracted from the death benefit paid to your heirs. In reality, your big lump-sum premium is committed for life, unless you are prepared to pay stiff surrender penalties.

High exit penalties. You can bail out of an SPL policy but at a price. Surrender charges run between 7% and 9% and decline to zero by the seventh-to-tenth policy year. In addition, income taxes must be paid on the accumulated investment earnings. That's a big deterrent to cashing in after the ten-year mark, when the earnings buildup has become substantial.

Fees and commissions. Sales, administrative and other fees on SPL policies range from 2% to 3% a year. These annual charges, though not as high as some mutual fund fees, can seriously dilute the compounding of investment earnings. Glenn Daily, an insurance analyst at Seidman Financial Services in New York, cites one typical variable life SPL policy in which the investments generated a 12%-a-year return but yielded policy owners—after fees—a mere 9.4% in the tenth year and 9.5% in the twentieth year.

Sluggish investment results. If you buy a variable life SPL, be advised that you will be locked into a handful of company-sponsored investment funds. Be further advised that insurance companies aren't known for sizzling stock market performance. Last year, insurance company equity portfolios tracked by Lipper Analytical Services rose an average 12.9%—three percentage points less than the average stock mutual fund.

Some companies pay lower fixed returns on whole life SPL policies than they do on annual-premium policies, but others are offering the moon. In SPLs promising unusually high returns, check the quality of the underlying investments. Executive Life Insurance of New York, Fidelity Bankers Life Insurance and others have loaded up on low-rated junk bonds in order to offer generous payoffs.

Political storm clouds. Deficit-conscious legislators are irked by insurance company ads touting SPLs as one of the last great tax shelters. Congress may well crack down on the tax-free policy loans and the buildup of investment earnings. If that happens, even the insurance lobby may not be able to win grandfathered status for existing policies. Tougher accounting rules being rumored for interest-sensitive investments could prove troublesome as well.

Superfluous insurance coverage. You must also ask yourself whether you want to pay a hefty sum now for a big slug of life insurance. A 45-year-old man might pay $25,000 to buy his heirs an $85,000 death benefit from a typical SPL policy. That's no bargain compared with term life insurance, which provides pure protection.

High-rate come-ons. Insist on seeing the performance records of the SPLs that you are considering. And remember that the high rates of return promised on whole life SPLs will expire in from one to three years. Warns Jim Kaiser, director of insurance services for Thomson McKinnon Securities: "Many insurance companies are attempting to take advantage of the current attractiveness of insurance products by offering introductory rates and special deals that are likely to terminate."

Understand that single-premium life insurance can be a good buy. But just remember that there are worse things in life than paying taxes.

—PHILIP SPRINGER

INVESTMENT UPDATE

Here's the current status of a number of investments, and a look at how they have fared over the past month and the past year.

INVESTMENT	(5/30/87) Recent Price or Yield	Value of $10,000 if invested: Month Earlier	Year Earlier
Common Stock (Index fund, capital gains and dividends reinvested)	$29.23/share	$10,104	$12,068
per cent change		+1.0%	+20.7%
Bonds (30-yr., 11¾% Treasury Bond)			
MARKET VALUE	$125.81	$ 9,805	$ 9,791
ACCUMULATED INCOME		$ 76	$ 914
TOTAL		$ 9,881	$10,705
per cent change		-1.2%	+7.1%
Money Market Fund	5.80%*	$10,049*	$10,570*
per cent change		+.5%*	+5.7%*
Gold (Krugerrands)	$454.50/oz.	$ 9,859	$13,117
per cent change		-1.4%	+31.2%
HOUSE PRICES	**Recent**	**Month Earlier**	**Year Earlier**
Existing House	$116,500	$121,700	$106,000
per cent change		-4.3%	+9.9%
New House	$133,700	$136,900	$114,700
per cent change		-2.3%	+16.6%

Sources: Vanguard Group Inc.; Salomon Brothers; Donoghue's Money Fund Report; Manfra, Tordella & Brookes, Inc.; Federal Home Loan Bank Board. * Estimate.